CRE Finance Council®
The Voice of Commercial Real Estate Finance

October 17, 2018

Via electronic submission – www.regulations.gov

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC-2018-0010

Ann E. Misback, Secretary
Board of Governors
Federal Reserve System
20th Street & Constitution Ave. NW
Washington, DC 20551
Docket No. R-1576
RIN 7100-AF 06

Robert E. Feldman, Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AE67

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549
File Number S7-14-18

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581
RIN 3038-AE72

RE: Proposed Revisions to the Volcker Rule

To Whom It May Concern:

The Commercial Real Estate Finance Council (CREFC) appreciates this opportunity to comment on the Agencies' proposed amendments (Proposal) to the so-called "Volcker Rule."[1] We applaud the Agencies' efforts to streamline and clarify key portions of the current rule, which is widely viewed as overly prescriptive and extending beyond statutory intent.

[1] Office of the Comptroller of the Currency (OCC), Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC), Securities and Exchange Commission (SEC), and Commodity Futures Trading Commission (CFTC), Notice of Proposed Rulemaking, *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships with, Hedge Funds and Private Equity Funds*, 83 Fed. Reg. 33432 (July 17, 2018) (hereinafter "Proposed Rule" or "Proposal").

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By way of background, CREFC's members represent U.S. commercial and multifamily real estate investors, lenders, and service providers – a market valued at an estimated $6.3 trillion supported by $4.05 trillion of commercial real estate (CRE) debt. Commercial banking organizations and the commercial mortgage-backed securities (CMBS) market are two of the top sources of private debt for commercial and multifamily real estate.

The CMBS market in particular continues to provide an important source of funding for the real economy. The CMBS market saw nearly zero issuance in 2009 but slowly recovered from the financial crisis with volume rebounding, albeit unevenly, over the last several years. At today's levels, the CMBS market serves as a sound source of debt for secondary and tertiary market real estate owners and operators.

As expressed by CREFC in previous letters to the Agencies,[2] however, CMBS is facing severe regulatory impediments, many of them contributing to a secular erosion of secondary-market liquidity and a reduction in post-crisis issuance volume. The Volcker Rule itself has played a material role in how banks allocate their resources and has correspondingly contributed to this liquidity decline.[3]

CREFC has worked closely with other industry stakeholders to develop recommendations regarding the Proposal and we echo the comments submitted by the Securities Industry and Financial Markets Association (SIFMA). Below, we have included recommendations on the issues that likely will be most impactful for CREFC's members, including revisions and clarifications to the definition of "trading account" and removal of unnecessary barriers for permitted activities like market-making. In addition to the recommendations highlighted below, CREFC broadly supports the recommendations included in the SIFMA letter of October 17, 2018.

Consistent with these views, our comments include:

I. Support for removal of Appendix B to the 2013 Original Rule,[4] which would essentially permit a banking entity with significant trading assets and liabilities to

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[2] *See, e.g.*, Letter from Lisa Pendergast, Executive Director, Commercial Real Estate Finance Council, to Keith Noreika, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (Sept. 26, 2017), available at www.regulations.gov, Tracking No. 1k1-8yvw-8zqu, Docket ID: OCC-2017-0014-0067.

[3] *See, id.* CREFC's letter in response to the OCC's request for public input on amending the Volcker Rule, 82 Fed. Reg. 36692 (Aug. 7, 2017), discusses at length the impact of the Volcker Rule on the CMBS market. We do not reiterate that information here, but incorporate it herein by reference.

[4] Fed, FDIC, OCC, and SEC, Final Rule, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships with, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5,536 (Jan. 31, 2014); CFTC, Final Rule, *Prohibitions and Restrictions on*

integrate compliance programs and satisfy Volcker Rule requirements with existing compliance regimes;

II. Opposition to the proposed accounting-based prong of the definition of "trading account" and support for retaining the two existing tests (both the dealer and market risk capital prongs) as adequate;

III. Support (for purposes of permissible underwriting and market-making activities) generally for the proposed presumption of reasonably expected near-term demands (RENTD) of clients, customers, and/or counterparties based on internal risk limits, though members recommend certain modifications to proposed requirements related to RENTD; and

IV. Support for removal of the correlation analysis and "demonstrable reduction in specific risks" requirements for permissible hedging activities, as well as repeal of the enhanced documentation requirement for all covered entities.

RECOMMENDATIONS RELATED TO THE PROPOSED RULE

CREFC welcomes the Agencies' proposals to simplify the 2013 Original Rule and better align it with statutory purposes, which include:

- Promoting and enhancing the safety and soundness of banking entities;
- Protecting taxpayers, consumers, and overall U.S. financial stability from banks that engage in unsafe and unsound activities; and
- Limiting activities that in the past have caused undue risk or loss in banking entities.[5]

In our members' experience, the Volcker Rule has not proven to be – in its current form – an efficient or effective tool for controlling excess risk in the financial system for a number of reasons, including:

- Poorly scoped definitions inadvertently ensnare permissible activities that are essential to the health and welfare of the U.S. financial system (e.g., market-making, hedging, and asset/liability management (ALM)); and
- A lack of harmonization exists between the Volcker Rule and the extensive risk governance and analytic systems required by the Basel framework and the Dodd-

Proprietary Trading and Certain Interests In, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5808 (Jan. 31, 2014) (collectively, the "2013 Original Rule").

[5] *See* 12 U.S.C. § 1851 (instructing the Financial Stability Oversight Council to make recommendations on implementing the Volcker Rule to achieve these and other purposes).

Frank Act's enhanced prudential standards,[6] which are already institutionalized at large banks.

Overall, these fundamental problems with the 2013 Original Rule are causing a misalignment of focus and resources at the Agencies and the banks. The specific recommendations outlined below will help address that misalignment and reduce other unintended negative consequences flowing from the current rule.

I. As Proposed, Agencies should Remove Appendix B to the 2013 Original Rule and Finalize a Tailored Compliance Approach More Consistent with other Risk Governance Systems.

CREFC strongly supports removal of Appendix B, which will allow banks to integrate Volcker Rule compliance with the other risk governance systems noted above. Today, Appendix B is *extremely* prescriptive and does not account for banks' unique circumstances. The proposed compliance approach, on the other hand, is based on a bank's size and the nature of its activities and will provide meaningful flexibility for regulated institutions. Notably, elimination of Appendix B will allow banks to tailor their processes and leverage their current *extensive* compliance infrastructure to reduce unnecessary administrative burdens.

For these reasons and those articulated in the SIFMA submission, we support removal of Appendix B.

II. Agencies should Modify the Definition of "Trading Account" in a Manner that is Consistent with the Authorizing Statute and that Will Not Sweep in Permitted Activities.

CREFC members agree that in their current form the "short-term intent" prong and related 60-day rebuttable presumption are problematic, and we generally appreciate the Agencies' attempts to replace them with a more administrable and objective test. For reasons explained more fully in the SIFMA letter, however, the Agencies should not replace the short-term intent prong with the proposed accounting-based prong. Instead, the "trading account" definition should rest on the other two tests in the 2013 Original Rule (i.e., the dealer and market-risk capital prongs).

The proposed accounting prong would exacerbate the current rule's fundamental problem with poor definitional scope (i.e., line drawing between prohibited and permitted activities), not alleviate it. The accounting test is overly broad and would improperly pull into the Volcker regime long-term positions and permissible market-making, hedging, and ALM investments – investments that *promote* safety and soundness in the system, consistent with the policy goals of the law.

[6] Dodd-Frank's enhanced prudential standards require the largest banks to follow rules for heightened oversight, measuring, and monitoring, including stress tests, Comprehensive Capital Review and Analysis, living wills, risk assessments, and more.

In the event the Agencies determine that a third prong is necessary, it should be designed to apply only to U.S. banking entities and foreign banking organizations that are not captured by the dealer or market risk capital prongs and should include a rebuttable presumption of compliance (similar to the current 60-day presumption with certain modifications to better align it with the other two prongs).[7] In addition, CREFC supports the recommendation that covered entities should be provided a reasonable challenge procedure to address disagreements with supervisors.

III. The Agencies should Remove Unnecessary Barriers to Permitted Activities and Finalize the Proposed Presumption of RENTD for the Underwriting and Market-Making Exemptions.

CREFC supports the proposed presumption of RENTD based on compliance with internal risk limits for permitted underwriting and market-making activities. Under the current rule, the "demonstrable analysis" requirement to show compliance with RENTD is cumbersome and costly, and it does not provide a clear line for banks trying to determine what is permissible versus impermissible. Not surprisingly, therefore, the RENTD requirement has had a dampening effect on these activities that were never intended to be captured within the Volcker Rule's prohibitions. This unnecessary barrier to *bona fide* market-making activity has, as noted above, decreased liquidity in secondary markets. Further, the proposed presumption does provide some harmonization with banks' enterprise risk management frameworks, which historically have served both supervisors and the industry by allowing banks to use their internal risk limits as a proxy for allowable inventory.

CREFC also supports SIFMA's recommendations that the Agencies refrain from adding another reporting requirement in the event of a risk limit breach and should instead integrate such reporting into existing supervisory processes. The importance of a breach can vary greatly depending on the size and the reason for the breach. If the objective is to achieve better understanding of the causes for breaches and remediation actions taken, the goal would best be achieved through the supervisory process and not through an unnecessarily burdensome and prescriptive approach.

IV. The Agencies should Remove Unduly Burdensome and Complex Requirements for Permitted Hedging Activities.

CREFC supports the Agencies' proposal to repeal the requirements for correlation analysis and determination of specific risks for permitted hedging activities. CREFC also supports SIFMA's recommendation that the enhanced documentation requirement be repealed for all banks. Taken

[7] As described in more detail in the SIFMA letter of October 17, 2018: "[T]he Agencies should include within any third prong a rebuttable presumption of compliance. Under this rebuttable presumption, any position that is not captured by the market risk capital prong or the dealer prong but is held by the banking entity as principal for sixty days or more would be presumed not to be for the trading account. Shifting the presumption in this way would ensure that any third prong does not improperly scope in long-term investments not intended to be captured by Section 13 of the BHC Act…."

together, these changes will materially alleviate unnecessary constraints on hedging necessary to mitigate structural risks at the institutional level.

For the CRE sector, effective hedging can be challenging, even more so than for other commercial sectors. It is therefore important for CRE portfolios in particular to maintain flexibility to deploy existing and future instruments as hedges and to dynamically and efficiently react to changes in the marketplace.

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Again, for the reasons set forth above and those described in the SIFMA letter, CREFC supports the Agencies' efforts to meaningfully revise the Volcker Rule. We agree with the general intention to provide more flexibility in managing investment banking, trading, and balance-sheet management activities. A less prescriptive approach will benefit the industry, helping it to better meet the needs of its clients and shareholders, and the Agencies themselves by achieving better alignment with the principles of risk management and safety and soundness.

Sincerely,

Lisa A. Pendergast

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Executive Director
CRE Finance Council
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